

ORIGINAL



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MEMORANDUM

30A

TO: Docket Control

FROM: Ernest G. Johnson
for Director
Utilities Division

DATE: September 1, 2006

RE: DIABLO VILLAGE WATER COMPANY APPLICATION FOR AN EXTENSION
OF ITS CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE
WATER SERVICE IN PIMA COUNTY, ARIZONA (DOCKET NO. W-02309A-
05-0501)

Attached is the Second Amended Staff Report for the above referenced application. Staff recommends approval of the requested extension.

EGJ:LAJ:mfm

Originator: Linda A. Jaress

Arizona Corporation Commission

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Docket No. W-02039A-05-0501

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**SECOND AMENDED STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

DIABLO VILLAGE WATER COMPANY

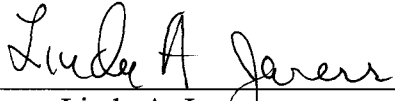
Docket No. W-02039A-05-0501

**APPLICATION FOR AN EXTENSION OF ITS CERTIFICATE OF CONVENIENCE
AND NECESSITY
TO PROVIDE WATER SERVICE IN PIMA COUNTY, ARIZONA**

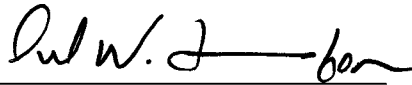
September 1, 2006

STAFF ACKNOWLEDGEMENT

The Amended Staff Report for Diablo Village Water Company (Docket No. W-02039A-05-0501) was prepared by the Staff members listed below. Linda Jaress performed the review and analyses of the Company's application. Dorothy M. Hains performed the engineering and technical analysis.



Linda A. Jaress
Executive Consultant III



Dorothy M. Hains
Utilities Engineer

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Introduction

On July 14, 2005, Diablo Village Water Company ("Diablo") filed an application for approval to extend its Certificate of Convenience and Necessity ("CC&N") to serve one additional section of land, approximately one square mile. The area would encompass a new 1,500-lot subdivision and a park. The developer originally planned a pomegranate orchard but later rejected the pomegranate farm in favor of a park with pomegranate trees in order to comply with the Arizona Department of Water Resources requirements.

Diablo's Operations

Diablo Village serves approximately 734 customers near the Tucson Airport in Pima County, Arizona. Diablo Village charges rates set in 2001 in Decision No. 65044. The rates for a ¾ inch meter include a \$20 per month basic service charge and \$3.00 per 1,000 gallons for all usage.

Diablo is currently in poor financial health. According to its 2005 Annual Report to the Arizona Corporation Commission ("Commission"), for the year ending December 31, 2005, Diablo experienced a net loss of \$39,837 on revenues of \$250,279. The Company's capital structure cannot be determined because the balance sheet does not balance.

Diablo's Water System

Attached as Exhibit 1, is Staff's Second Amended Engineering Report which describes the Company's current and planned system and capacity. The Report describes the Diablo Village system as including one 210,000 gallon storage tank and one well which is capable of producing 400 gallons per minute ("GPM"). According to the Company's August 17, 2005 response to Staff's Insufficiency Letter, this well is not owned by Diablo. On the Approval of Construction to equip the well issued by Pima County Department of Environmental Quality, the owner is listed as Thim Utility Co./Nordic Water Corp. In an August 19, 2005 email, the Company indicated that it received the bulk of its water from a sister corporation called Water Supply Corp.

The Company also has a contract with the City of Tucson ("City") in which the City agrees to sell 44,000 ccf per year of potable water. According to Diablo's 2005 annual report to the Commission, it purchased approximately 37,000 gallons from the City of Tucson during 2005.

According to Section 2.A of the Covenants of the contract with the City, "If Company acquires new customers after the effective date of this agreement, the designated capacity shall expand by 190 ccf per residential connection. Company shall not be entitled to expand its designated capacity for customers acquired through the development of subdivisions under the Assured Water Supply requirements of the Arizona Department of Water Resources." According to Diablo, there is some disagreement between Diablo and the City concerning

interpretation of the contract and whether water may be purchased for the purpose of serving the new subdivision.

A new well has already been constructed to serve the extension area. Two 5,000 gallon pressure tanks and one 300,000 gallon storage tank are planned. According to Diablo's response to Staff's insufficiency letter, the well was completed September 1, 2005 and cost \$122,345. It is located within Diablo's CC&N, directly across a road from Section 18, which is the area requested. Staff's Engineering Report indicates that the additional well and proposed storage should be sufficient to serve the development and to serve expected growth in the existing service area.

Wastewater

According to testimony at the hearing on May 11, 2006, the developers of the proposed subdivision and park are contributing to an expansion of a nearby Pima County wastewater treatment plant which will process the wastewater from the development.

City of Tucson

On February 10, 2006, the City of Tucson ("the City" or "Tucson") filed a request for intervention in this matter. Tucson also filed a copy of a map of its "50-year Service Area" within which Diablo and the proposed extension are located. Tucson has not received requests for service from the developer in the extension area. However, Tucson owns and operates a water main located adjacent to the proposed service territory.

According to the City's website (<http://www.ci.tucson.az.us/water/index.htm>) the City is actively promoting water conservation. It is pursuing several recharge projects using Central Arizona Project water or wastewater effluent. The City also operates a reclaimed water system which delivers treated wastewater for irrigating parks, golf courses, and schools. To further its conservation program, the City also offers free Water\$mart workshops including classes in desert landscaping, drip irrigation and harvesting rainwater for landscape use. Also, the City's tiered rate structure encourages conservation.

Costs

In response to a Company data request, the City listed the costs of providing service to the area at issue. The developer would incur the expense of purchasing and installing the distribution lines, valves, hydrants and service connections if the developer chose to be served by the City. The developer would incur these same expenses if it were served by Diablo.

The City has estimated that it will cost \$50,000 to interconnect with the Diablo system. Using 2005 cost data, Staff estimates the cost to install the two miles of 8-inch main to the interconnection site would be \$351,964. Furthermore, the City would charge the developer a System Equity Fee (a fee to recover a share of the cost of back-bone plant) of \$1,416 per 5/8 inch meter and a meter connection charge of \$1,170 per residence. With expected build-out of 1,500

homes, the total fees to the developer if served by the City would be approximately \$3.9 million, not including the interconnection cost. Diablo does not have a hook-up fee tariff. It will only charge \$350 per connection as a service line and meter installation charge, which for 1,500 homes would total \$525,000.

The record is unclear as to who is paying for the infrastructure. Diablo appears to be paying for the infrastructure for which the City ordinarily charges the System Equity fee. According to Diablo, as of February 13, 2006, "We have paid for the drilling of the new well, purchased the pump and boosters and are obligated in excess of \$400,000 for the new well project to date." Because Diablo will be paying for the backbone plant to serve the development and park, it will cost the developer much less to be served by Diablo.

The cost of the project per the Company's data as amended by Staff in the Engineering Report is \$524,339. If found used and useful, the investment in the new plant made by Diablo will increase ratebase significantly.

Arizona Department of Environmental Quality ("ADEQ")

Diablo is in compliance with ADEQ. Diablo's water meets the new arsenic standards.

Pima County Department of Environmental Quality Technical Services Division ("Pima County")

Diablo has received an approval to Construct ("ATC") for the proposed well and pressure tanks. Staff recommends that Diablo file with Docket Control as a compliance item, a copy of Pima County's Approval to Construct for the proposed 300,000 gallon storage tank within one year of the effective date of the Commission's decision in this matter.

Arizona Department of Water Resources ("ADWR")

According to ADWR, the new well is owned by Water Supply Corp. The Commission's Corporations Division indicates that Water Supply Corp. is owned by Robin Thim, the owner of Diablo. Staff believes that it is not in the public interest for wells to be owned by a party other than the water company which supplies service to the customers. Ownership by another party may lead to ownership, easement and lease disputes, especially if the water company is sold. Therefore, Staff recommends that the Commission order the Company to transfer both wells into Diablo and file as a compliance item with Docket Control a copy of the revised ADWR documents showing that the wells are owned by Diablo Village Water Company. This transfer and compliance filing shall be made within six months of the effective date of an order approving the requested extension.

Staff also recommends that the Company file a copy of the developer's Certificate of Assured Water Supply from ADWR with Docket Control as a compliance item within one year of the effective date of a Decision in the case approving the extension. This is especially important due to the replacement of the pomegranate farm by a park.

Conclusions and Recommendations

As stated in the first Amended Staff Report, Staff believes that over the long run, it is in the public interest for the City to provide water to the extension area. This conclusion is based upon the City's conservation program, its planning program and Diablo's location close to the City's main pipe. However, due to the developer's request to be served by Diablo, Diablo's ability to provide service to the developer at a lower cost than the City, and the possible economies of scale that Diablo could reap from the addition of 1,500 customers, Staff recommends approval of the extension.

Staff also recommends the Commission order Diablo to submit a copy of Pima County's Approval to Construct for the proposed 300,000 gallon storage tank as a compliance item within one year of the effective date of an order approving the requested extension.

Although the Company has filed a curtailment tariff, it has since changed its plans in a manner which impacts the form of a proper curtailment tariff. Therefore, Staff recommends the Commission order the Company to file a curtailment tariff in Docket Control as a compliance item within 45 days of the decision in this case.

Staff recommends that the Commission order the Company to transfer the wells into Diablo and file as a compliance item with Docket Control, a copy of ADWR documents showing that the wells are owned by Diablo Village Water Company. This compliance filing shall be made within six months of the effective date of an order approving the requested extension.

Staff recommends the Commission order the Company to file a copy of the developer's Certificate of Assured Water Supply for Section 18 from ADWR with Docket Control as a compliance item within one year of the effective date of a Decision in the case approving the extension.

Staff recommends that the Commission order Diablo to keep its accounts according to the NARUC system of accounts as required by R14-2-411.D.2. The Commission should also order Diablo to file a statement from a Certified Public Accountant indicating that the Company's books and records are being kept in compliance with the NARUC system of accounts within 6 months of the date of the decision in this case. Staff recommends the statement be filed in Docket Control as a compliance item.


Due to the poor financial health of Diablo and rates that do not encourage conservation, Staff recommends the Commission order Diablo to file a rate case by June 30, 2007, using a calendar year 2006 test year.

If Diablo does not comply within the conditions listed above within the time specified, the approval of the extension should be null and void after due process.

MEMORANDUM

DATE August 24, 2006

TO: Linda Jaress

FROM: Dorothy Hains 

RE: **SECOND AMENDED ENGINEERING REPORT**
Diablo Village Water Co.
Application to extend its CC&N to provide water service
Docket Nos. W-02309A-05-0501

I. Introduction

Diablo Village Water Company ("Diablo Village" or the "Company") filed comments addressing the Staff Report for Diablo Village CC&N extension application on December 23, 2005. The City of Tucson ("City") filed a motion to intervene in this application on February 8, 2006. This amended report addresses comments filed by the Company on December 23, 2005 and issued raised by the City's intervention.

The requested area is contiguous to the Company's existing service area. Diablo Village has informed Staff that the requested area has sold to two companies, Arboreal Agricultural Resources, LLC ("Arboreal") and Pomegranate Farms I, LLC ("Pomegranate"). Arboreal owns 40 acres and plans to develop this parcel of land into a large park that includes a combination of non-fruit bearing trees and less than two acres of fruit bearing trees. The remaining 600 acres of land owned by Pomegranate will be developed into a 1,500 unit housing project which will include two schools, a fire department and some light commercial properties.

II. Water System Analysis

A. Existing System

Diablo Village owns and operates a system which includes one well which is capable of producing 400 gallons per minute ("GPM") and one 210,000 gallon storage tank. The City owns a forty two inch transmission line along Valencia Rd. There is also an eight inch service line in Valencia Road to serve Diablo Village's existing CC&N area. The Company has a service agreement¹ with the City which the Company may utilize when needed. Diablo Village's existing water system has adequate production

¹ The Agreement provides that the City will sell 500 GPM of water for use in the Company's existing CC&N area, according to the City the agreement doesn't allow this water to be used outside the existing CC&N area.

and storage capacity to serve the existing customer base of 500 connections plus an additional 750 connections.

B. Proposed Plant Additions

Pomegranate proposes to construct a new plant which will be used to serve its new housing development. This proposed plant includes a well² with a production rate of 550 GPM, two 5,000 gallon pressure tanks and one 300,000 gallon steel storage tank. Based on Staff's calculations, this new plant coupled with the City water and the well and storage capacity of the existing Diablo Village system should be adequate to serve the new housing development and expected growth in the Company's existing service area.³ Pima County Department of Environmental Quality Technical Services Division ("Pima County") has issued an Approval to Construct (ATC) for the well (Arizona Department of Water Resources Well #55-208091) and two 5,000 gallon pressure tanks. Staff recommends that Diablo Village file with the Commission's Docket Control as a compliance item in this docket a copy of Pima County's ATC for the proposed 300,000 gallon storage tank with one year of the effective date of an order approving the requested extension. Because the new well is not registered in Diablo Village Water's name, Staff further recommends that the Company file the necessary paperwork with Arizona Department of Water Resources ("ADWR") so that the record reflects that the Company owns the well. Staff further recommends that the Company shall file with Docket Control, as a compliance item in this matter, a copy of the revised ADWR documents showing that the well is owned by Diablo Village Water Company. This compliance filing shall be made within six months of the effective date of an order approving the requested extension.

Diablo Village has not been able to provide Staff with specific information on how much water will be used by the schools, fire department and commercial properties or the park. However, Staff believes that the Company will have sufficient surplus capacity to serve these customers.⁴ Furthermore, if additional well and/or storage capacity is needed in the future it is reasonable to assume that Diablo Village will develop the additional capacity needed.

Staff's concludes that Diablo Village will have adequate capacity to serve the existing and proposed CC&N areas assuming that 500 GPM of City water will continue to be available to serve Diablo Village customers. Without the City water Diablo Village will not have adequate capacity to serve the existing and proposed CC&N area.

² According to ADWR, the registered owner of well #55-208091 is Water Supply Co. Water Supply Co. is owned by Robin Thim who also owns Diablo Village Water Company.

³ According to Staff's calculations the Company will have adequate capacity to serve approximately 2,600 connections.

⁴ The Company will have enough capacity to serve an additional 600 residential connections plus Arboreal plans to utilize a low water use drip irrigation system and only irrigate during the night time hours.

C. Estimated Cost For The Company To Serve the Requested Area

The Company estimated plant additions are listed in the table below:

Items	Estimated costs by Diablo Village (\$)	Staff adjustment (\$)
Well (ADWR # 55-208091)	122,345.00	None
Pump upgrades	66,604.35	None
One 300,000 gallon storage tank	200,000.00	None
Two 5,000 gallon pressure tanks	0	48,000.00
total	388,949.35	48,000.00
20% engineering & contingencies	77,790.00	9,600.00

The cost of project per the Company's estimates as amended by Staff is \$524,339⁵.

Staff concludes that the estimated costs as amended by Staff are reasonable and appropriate. However, Staff has not made a determination of the capital improvements as "used and useful" at this time, but defers this determination until Diablo Village files its next rate application.

D. Estimated Cost For The City To Serve the Requested Area

Using 2005 cost data Staff estimates the cost to install two miles of 8-inch main so that the City could serve the requested area would be \$351,964⁶. However, the City has stated that its interconnection cost will be \$50,000.

⁵ The sum of \$338,949 plus the overhead of \$77,790 plus Staff's adjustments of \$48,000 and \$9,600 totals \$524,339.

⁶ Unit cost to install an 8-inch pipeline including labor is \$33.33/ft.

Other Issues

A. Arsenic

Test results from samples taken from the proposed well show that the arsenic concentration is 1.3 micro grams per liter (or 1.3 ppb) which is below the new arsenic standard of 10 ppb. The arsenic level in Diablo Village existing well is also below the new standard of 10 ppb.

B. Curtailment Tariff

Diablo Village has an approved Curtailment Tariff for a Consecutive Water System. Since, the Company is no longer operating as a secondary water supplier (as a consecutive system), the Company recently filed to modify its existing curtailment tariff to reflect this. Staff has reviewed the curtailment tariff that was filed by the Company in this Docket on May 10, 2006 and found that it is consistent with the terms, and conditions contained in Staff's model tariff which has been approved by the Commission for other water companies at that time. Although the Company has filed a curtailment tariff, it has since changed its plans in a manner which impacts the form of a proper curtailment tariff. Therefore, Staff recommends the Commission order the Company to file a curtailment tariff in Docket Control as a compliance item within 45 days of the decision in this case.

Staff further recommends that the tariff shall generally conform to the sample tariff found on the Commission's web site at www.cc.state.az.us. Staff recognizes that Diablo Village may need to make minor modifications according to their specific management, operational, and design requirements as necessary and appropriate.

III. Summary

Conclusions

1. Diablo Village's existing water system has adequate production and storage capacity to serve the existing customer base of 500 connections plus an additional 750 connections.
2. Staff concludes that Diablo Village will have adequate storage and production capacities to serve entire requested area. Furthermore if additional well and/or storage capacity is needed in the future it is reasonable to assume that Diablo Village will develop the additional capacity needed. Staff's conclusion that Diablo Village will have adequate capacity to serve the existing and proposed CC&N area assumes that 500 GPM of City water will continue to be available to

serve Diablo Village customers. Without City water Diablo Village will not have adequate capacity to serve the existing and proposed CC&N area.

3. The cost of project per the Company's data as amended by Staff is \$524,339.
4. Staff concludes that the estimated costs as amended by Staff are reasonable and appropriate. However, Staff has not made a determination of the capital improvements as "used and useful" at this time, but defers this determination until Diablo Village files its next rate application.
5. Using 2005 cost data Staff estimates the cost to install two miles of 8-inch main so that the City could serve the requested area would be \$351,964. However, the City has stated that its interconnection cost will be \$50,000.

Recommendations

1. Staff recommends that Diablo Village file with the Commission's Docket Control as a compliance item in this docket a copy of Pima County's ATC for the proposed 300,000 gallon storage tank with one year of the effective date of an order approving the requested extension. Because the new well is not registered in Diablo Village Water's name, Staff further recommends that the Company file the necessary paperwork with ADWR so that the record reflects that the Company owns the well. Staff further recommends that the Company shall file with Docket Control, as a compliance item in this matter, a copy of the revised ADWR documents showing that the well is owned by Diablo Village Water Company. This compliance filing shall be made within six months of the effective date of an order approving the requested extension.
2. Staff recommends that the Company file a curtailment tariff as soon as possible, but no later than forty-five (45) days after the effective date of the order in this matter. The tariff shall be filed with the Commission's Docket Control as a compliance item in this docket for Staff's review and certification. Staff further recommends that the tariff shall generally conform to the sample tariff found on the Commission's web site at www.cc.state.az.us. Staff recognizes that Diablo Village may need to make minor modifications according to their specific management, operational, and design requirements as necessary and appropriate.